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In the Matter of	)	
Federal-State Joint Board on	)	**CC Docket 96-45**
Universal Service	)	

Further Comments of
Cathey, Hutton and Associates

December 19, 1996

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Executive Summary

Cathey, Hutton and Associates (CHA) is a full service consulting firm representing rural Incumbent Local Exchange Carriers (ILECs) nationwide. Most of CHA's client ILECs rely heavily upon the existing Universal Service program for a significant portion of their revenues and are keenly interested in the Commission's ongoing efforts to adapt Universal Service funding rules to the requirements imposed by Federal Telecommunications Act of 1996. CHA hereby submits these comments on behalf of its ILEC clients.

The Joint Board's recommendation to freeze rural ILEC USF and related revenues pending a transition to proxy-based costs does not go far enough to allow ILECs to recover existing costs incurred in support of prior universal service goals. The transition may not be long enough. Competitive neutrality is achieved by allowing eligible Competitive Local Exchange Carriers (CLECs) to receive USF support on the proxy-based costs of facility based loops, not for customers served by resold local dial tone services.

Benchmark revenues should also be calculated on a forward-looking basis consistent with forward looking costs. If both interstate and intrastate revenues are to be assessed in support of Federal Universal Service, states must be permitted to assess telecommunications carriers on the same basis for support of state programs. There are other transition issues which must be addressed. ILECs which purchased additional telephone property must be allowed to normalize their transitional USF. Average Schedule ILECs will require consideration.

Imposing Proxy Costs Upon ILECs Violates Several Principles of Section 254 of the Telecommunications Act. CLEC Use of Embedded Cost is NOT Competitively Neutral.

Federal law mandates interstate ratepayer support of the goals of the Telecommunications Act. This obligation extends equally to both the new and exciting advancement of public policy goals, such as support for schools and libraries, as it applies to old and mundane public policy such as support for the infrastructure deployed in rural, high cost and insular areas of the Nation. The same Joint Board which recommends discounts to schools and libraries of up to 90% has a commensurate obligation to provide sufficient support to the LECs responsible for providing essential telecommunications service to residences and business equally protected by the Federal Telecommunications Act of 1996.

Imposing proxy-based cost standards upon incumbent LECs violates the 1st, 3rd, 5th and proposed 7th principles of the Act. USF revenues will meet the "sufficient" support principle of the Act only accidentally in the case of ILECs whose actual costs approximate the proxy based costs.

Investments were made by ILECs in the good faith that an opportunity for recovery of the cost would continue to exist. In order to satisfy this regulatory compact and, perhaps more importantly, to satisfy the 5th universal service principal which requires specific and predictable (to both the payor and recipient) and sufficient (to the recipient) support, imposition of a proxy-based cost recovery mechanisms must wait until ILECs recover costs incurred in good faith. Only then can ILECs invest in facilities on the same, efficient and forward-looking basis as its competitors.

The Act has shifted some burden to the Federal USF ratepayer to insure just, reasonable and affordable rates, the first Universal Service principle. As mandates for pricing access and interconnection services reduce those sources of revenue to support universal service public policy, the Commission must recognize that, at the end of the day, the embedded costs of the ILEC do not go away. Renaming universal service cost in order to reduce the responsibility of the ratepayer can result in a significant shortfall which would then be recovered from the end user, leading to unjust, unreasonable, unaffordable and non-comparable rates .

The Joint Board's attempt to solve this problem through a freeze of existing ILEC USF and related revenues pending a transition should be extended for a longer period of time and either the FCC is obligated to implement a financial mechanism to recognize the existing costs incurred isn support of past Universal Service policies as discussed above. A longer transition is necessary and additional flexibility mandated to allow ILECs to recover their existing universal service costs which are in excess of the proxy-based costs.

In order to make USF support "portable" and available to all eligible carriers, the Joint Board recommends that support must be equal in the name of "competitive neutrality", the proposed seventh universal service principle. CHA believes competitive neutrality would ideally require any LEC seeking USF to justify its receipt on the basis of its individually identified actual costs. The Act requires that USF be properly targeted to only those eligible carriers that demonstrate a need.[1] We realize this policy may be unrealistic and therefore propose that, notwithstanding all of the flaws related to imposing the proxy based costs upon ILECs, CLECs serving as eligible carriers within a rural ILEC service territory should receive the proxy-based USF amount per line, not the embedded cost of the incumbent LEC. Competitive neutrality should allow equality of opportunity to achieve the public policy goal, not equal dollars. The Joint Board recommends that rural LECs enjoy the benefit of a transition from embedded cost-based USF support to support based on proxy-determined costs. The purpose of the transition is to provide for an orderly change from one set of rules to another. The Joint Board, at paragraph 283, correctly justifies a transition to recognize small and rural ILECs' difficulty accommodating rapid changes in operating circumstances.[2] This accommodation of the special needs of the rural LECs presumes the difference between embedded costs and proxy costs will be significant and that, in most cases, embedded costs represent the greater cost. There is no finding that a CLEC faces the same set of circumstances. In sharp contrast, CLECs are not facing operational change requiring a transition but are, in fact, facing market entry decisions, requiring appropriate market entry pricing signals from the new regulatory regime. Furthermore, facility based CLECs will either build their own modern, efficient network at forward looking costs or purchase an incumbent's unbundled network elements priced on the same forward-looking basis[3]. This

[1] See 254(e)

[2] As stated earlier in its comments, CHA believes the transition should be broadened to accommodate additional needs of ILECs which were not a part of the Joint Boards's justification of its transition.

[3]CHA assumes the clarification regarding reseller discussed elsewhere will prevail and thus the perverse effects of that scenario are not contemplated in this example.

method of acquiring a network is the same basis as USF cost determination under the proxy method endorsed by the Joint Board. Since USF will be calculated as the difference between costs (proxy or embedded) and benchmark revenues, and further assuming the benchmark revenue amount will be the same for ILECs and CLECs, requiring CLECs to calculate their costs in the exact same manner in which they are incurred, i.e. on an "efficient, forward-looking basis is, in fact, more competitively neutral than providing the new entrant the windfall associated with USF based upon an ILECs embedded costs. Both CLECs and ILECs will receive an appropriate level of USF representing the real differences between their respective costs and benchmark revenues even though the absolute level of USF each receives will be different during the transition.

Having concluded that the Joint Board's recommendation to base a CLECs support on the embedded cost of the ILECs violates the "Competitive Neutrality" principle as demonstrated above, the Joint Board is left with "administratively ease"[4] to support its findings. Notwithstanding the fact that "administrative ease" is not a Universal Service Principle, nothing associated with implementing this new USF will be easy and in fact will be incredibly complex therefore the Joint Board's use of "administrative ease" as a justification for its conclusion is, at best, marginal.

Finally, the Joint Board defends it correct conclusion that a transition is appropriate based upon the arguments that proxy methods may not be fully developed for application in rural

[4]See Paragraph 297

areas. The arguments the Joint Board found persuasive were primarily those advanced by rural LECs. Those rural LEC arguments finding fault with proxy methods were argued extensively by, among many other commentors, CLECs or entities likely to be CLECs. Thus a reasonable conclusion the Commission may reach is that CLECs are fully prepared to accept the USF support generated by proxy methods in all markets at the same time they are implemented for larger LECs. The Commission can thus satisfy CLECs by rejecting the Joint Board recommendation to base CLEC USF on the embedded costs of rural ILECs.

Universal Service Support Should Be Reserved For Only the Facilities-Based Services of Eligible Carriers.

The Joint Board correctly concludes that carriers can be determined "eligible" as defined in Section 214(e) by providing universal services through the use of their own facilities or a combination of their own facilities and the resale of another carrier's facilities. The Joint Board further concludes that eligible carriers will be paid a per line amount for any and all eligible (residential or single line business) access lines, however served (See footnote 952). It therefore appears that the Joint Board has concluded that USF be paid to resellers for services provided over resold lines. The Commission must reject this conclusion and rule that USF monies will be available to all eligible carriers but only for those specific, eligible access lines served by the loop and switching facilities owned by the carrier or acquired by purchase on an unbundled basis from any carrier at a price which represents full unseparated or forward looking cost as defined in the Commission's pricing rules. This means carriers deemed eligible using a combination of facilities and resold dial tone services will be paid only for the facilities lines they provide to qualified end users. We can not conceive of a circumstance where USF would be appropriately paid to a telecommunications carrier providing services on facilities acquired by the resale of local dial tone.

Resale of local services does not represent total, unseparated cost of facilities but is in fact a subsidized, discounted local service. The local rate to be discounted is the precisely-targeted public policy rate which is to be subsidized by the explicit USF subsidy as required by the Act. Flowing USF to a resold line priced on the basis of some USF contribution does not meet any test of a properly functioning USF program[5] and the perverse result of this recommended policy must be rejected by the Commission

For example, assume a proxy-determined cost of $50 per month per line offset by a benchmark revenue amount of $35 ($24.00 local plus $11.00 in access and other benchmark-defined revenues) generates USF of $15.00. Discounting the residential rate by 25%, a reseller would purchase local dial tone plus all other associated services for $18.00 ($24.00 x .75). Since the reseller is only purchasing local dial tone, the access charge revenue would still be billed by the facility based LEC. The incumbent carrier, still required to provision and maintain the facility, would bill $29.00 (discounted local rate of $18.00 plus access, etc. of $11.00). and would therefore lose $21.00 ($50 - $29 instead of the intended $6.00 avoided cost discount). Meanwhile, the reseller, having purchased discounted local service for $18.00 would receive USF of $15.00 thus reducing the cost to provide service to $3.00. There can

[5] USF must be used for the provision, maintenance and upgrading of facilities and services. USF should be competitively neutral.

be no rational policy which would support and encourage the above-described results. The Commission must affirm that this is not the intended result of its rules and clarify that USF is paid to carriers deemed eligible as the law states and the Joint Board recommends but that the per-line amounts are limited only to those that are provided over the eligible carriers facilities either owned outright or acquired through unbundled access. Furthermore, since the USF support is intended to support both loop and switching facilities and services, both switching and loops must be owned or controlled in the described manner.

Benchmark Revenues Should Be Calculated on the Same Forward-Looking Basis As the Costs They Are Intended to Offset.

The Joint Board recommends a "benchmark" revenue should be deducted from proxy-based forward-looking costs to determine the proper USF revenue per line. CHA believes the benchmark revenue must be calculated on the same forward-looking basis as the costs which are to be compared when calculating USF. ILECs must have an opportunity to reflect unbundled element revenues calculated on a forward looking basis when calculating the benchmark. Since current access charges are subject to further review, clearly the Commission must either accommodate the potential for change to these revenues or delay the calculation of benchmark revenues until an accurate, forward looking calculation of both unbundled elements and access revenues can be determined.

Revenues to be Used in the Determination and Allocation of USF Support Obligations Must Meet the Act's Objectives.

The Joint Board recommends that interstate and intrastate revenues support the school and library portion of the new USF but does not yet agree on the appropriate base for the rural, high cost and insular areas support calculation. Clearly, the Joint Board believes an allocation basis which includes interstate and intrastate revenues is both legal and appropriate, at least for support of schools and libraries. Nothing prevents the Joint Board or the Commission from reaching the same conclusion with respect to the high cost portion of the universal service program. CHA believes all revenues, state and interstate, should be included in the allocation base for support to high cost areas but only on the condition states can include all revenues, state and interstate, generated within a state in support of that state's high cost fund. In order to be competitively neutral, all revenues should be included in the base of any and all Federal subsidy program(s) developed. Federal programs should draw upon the resources of all 50 states to support Federal policy goals and to prevent incentives to mischaracterize traffic to evade financial responsibility to support the Commission's policy goals. Absent states' rights to allocate support to interstate revenues generated within a state, the FCC should limit all USF allocations, including school and library support, to interstate revenues.

There Are Unresolved Problems With the Frozen and Transitional USF.

The Joint Board recommends freezing the 1997 USF, LTS and DEM revenues of rural LECs for three years, then transitioning these frozen revenues to a proxy-based cost basis over an additional three years through the year 2003 at which time all LECs will base USF support upon proxy-based costs. Furthermore, the Joint Board recommends new entrants be eligible to receive the same amount of frozen embedded-cost based support per line during the transition period.

While CHA commends the Joint Board for its attempt to ameliorate the potential for abrupt and potentially devastating financial harm as a result of the new pro-competitive policies through the use of a transition, we believe there are numerous problems with this approach.

Some LECs submitted 1995 financial data to the USF administrator which reflects acquisition of telephone property during 1995. This will result in abnormal 1997 USF revenues. Numerous petitions have been filed before the Commission seeking to correct the unintended results which, by all accounts, should impact only the USF associated with the year of acquisition. The Commission must not memorialize these unintended results, potentially for up to 6 years. The Commission should allow those affected carriers to submit normalized cost data to be used in the calculation of the frozen USF amounts. The Commission should establish an expedited waiver process to account for and correct the timing problem experienced by the affected LECs.

Other LECs may have had anomalous operating results in the test year for freezing USF, LTS and DEM resulting in exceptionally low frozen and transitional USF. A single year of low USF may not reflect the LEC's normal operating results and should not be incorrectly frozen simply due to an accident of timing. LECs with demonstrably lower combination of USF, LTS and DEM in the test year, e.g., 30% lower than a three year average would suggest, should be allowed to average the USF, LTS and DEM weighting amounts of the past three years in order to establish a more appropriate frozen amount.

ILECs converting to cost from average schedule may require special consideration with regard to timing issues. DEM weighting issues may arise which could complicate the transition. We believe the Commission must maintain flexibility and allow for final adjustments to the cost attributes which are to be frozen for the transition period to accurately reflect costs.

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December 19, 1996

By:

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CERTIFICATE OF SERVICE

I, Kent Larsen, hereby certify that a copy of the foregoing Further Comments of Cathey, Hutton & Associates in CC Docket 96-45 was served on this 19th day of December, 1996, by first class, U.S. mail, postage prepaid, to the following parties on the attached pages:

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